Manitoba

MANITOBA'S POSITION ON

FEDERAL-PROVINCIAL FISCAL ARRANGEMENTS

Honourable Howard Pawley
Premier of Manitoba

ANNUAL CONFERENCE
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Equalization: Evaluating the Commitment

Annual Conference of First Ministers
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Prologue

"As a result (of the Constitutional Division of taxing powers, applied to the existing regional distribution of taxable income), Canadian citizens in some provinces are receiving educational, health and other social services much inferior to those in other provinces and...Canadian citizens in some provinces are required to contribute a much larger portion of their income to the government of the province than those in other provinces.

Rowell-Sirois Commission Report
Canada 1939, Book II, 79

An increment to federal grants could be made whenever a "provincial government established that it could not supply Canadian average standards of service and balance its budget without taxation (provincial and municipal) appreciably exceeding the national average in relation to income."

Ibid.

"Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation."

The Canada Act, 1982
Section 36(2)

Background

Though written nearly 50 years ago, the Rowell-Sirois Commission Report identified the inequities which result from uncorrected regional fiscal imbalance.

The solution is also identified -- a national commitment of funding to sustain average standards of service without excessive taxation. That commitment was entrenched in our Constitution in 1982.

The recent series of cutbacks in federal transfer payments for health and higher education and for equalization are beginning to be felt with the result that some provinces do not have sufficient fiscal capacity to maintain important services for their citizens.

The equalization program is now under review. The formula imposed in 1982 has proven to be grossly inadequate and unfair to recipient provinces.

The federal commitment to fairness and to equity for all Canadians must be renewed. The equalization program needs improvement now.

The Government of Manitoba has examined the program carefully, and documented its deficiencies and the potential consequences. Manitoba proposes a return to equalization based upon a national average standard. This would provide federal equalization payments more in keeping with those earlier proposals of the Rowell-Sirois Commission, with the historical evolution of the Canadian equalization arrangements, and with the commitment enshrined in our Constitution.

The Constitutional Commitment

Canada, as a nation with disparate parts, has a long history of sharing the economic and social benefits of Confederation. Our major provincial social programs — health care, post-secondary education, social assistance -- have long been supported by national programs to provide the crucial financial underpinning on which such commitments depend.

Equalization is provided to ensure more equal capacity for the provinces to meet their responsibilities. The commitment to equalization entrenched in our Constitution in 1982 is virtually the same as proposed by the Rowell-Sirois Royal Commission in 1939.

Modern equalization arrangements have focussed on revenuegenerating capacity and, beginning 30 years ago, have been formalized through the development of equalization formulae.

Today, all Canadians can be proud that each and every provincial government, whether representing an equalization recipient province or one more fortunate, supports the maintenance of a fair and adequate equalization program.

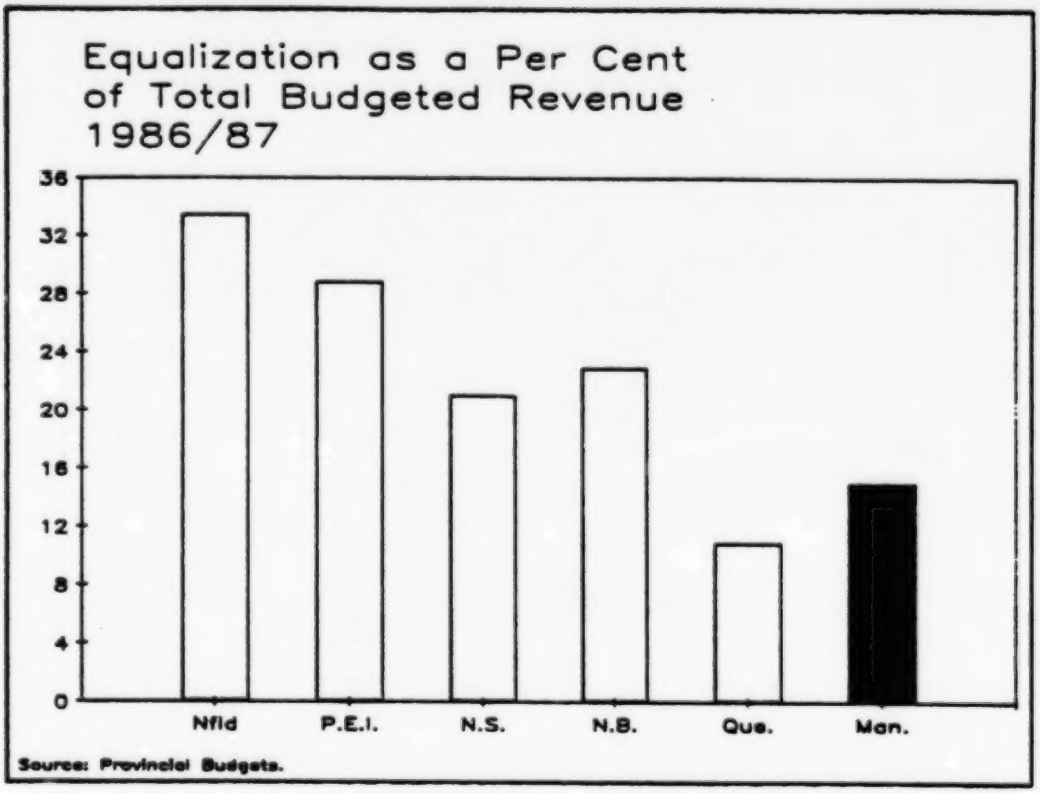
And yet, gathering clouds now obscure past accomplishments. The commitment of ordinary Canadians to their social heritage is strong throughout the country. However, federal actions and in some cases inaction suggest that Medicare, post-secondary education and all other provincial social and economic programs are somehow of less priority today in Canada than only a few years ago. The Constitutional objective is now placed at risk by federal fiscal decisions which undercut the foundation on which these programs have been built. If not reversed, these decisions will lead inevitably to decay, beginning in the more vulnerable regions, but eventually affecting even the strong.

The Importance of Equalization

It is difficult to overstate the importance of equalization to Canadians. It provides a measure of fairness and equity in sharing the benefits of the Canadian federation. It serves vitally important social purposes — without equalization, national standards for health, education, social assistance and other provincial programs would not be possible. Equalization may also be our most important regional development program. Without the ability to provide comparable services with comparable taxation levels, poorer provinces are at a severe disadvantage in attracting industry and developing their own economic base.

Equalization currently provides from 11% to 33% of the total budgeted revenue of recipient provinces. As shown in Chart 1, it currently provides 15% of Manitoba's revenue.

Chart 1

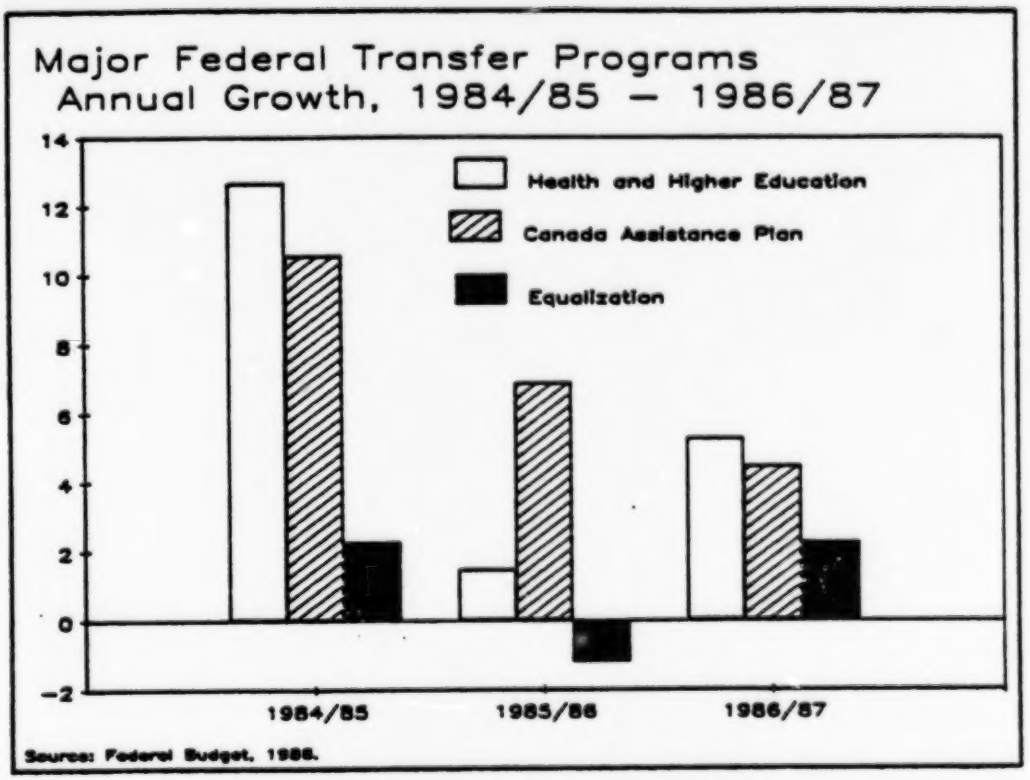


Equalization in the Context of Total Federal Transfers

For each of the six recipient provinces, equalization comprises the largest component of federal cash transfers. In terms of total cost to the federal government it ranks second behind federal cash transfers for health and higher education. The third largest of the federal transfers are those provided through the Canada Assistance Plan. Other shared-cost or specific purpose transfers account for the remaining 5% of total federal transfers.

While each of the major transfers has recently shown much lower growth than in the 1970's and the early 1980's, equalization, as indicated in Chart 2, has shown virtually no growth over a three-year period and actually declined in 1985/86. Equalization support has been far from sufficient to meet the increasing costs of maintaining services for an expanding population.

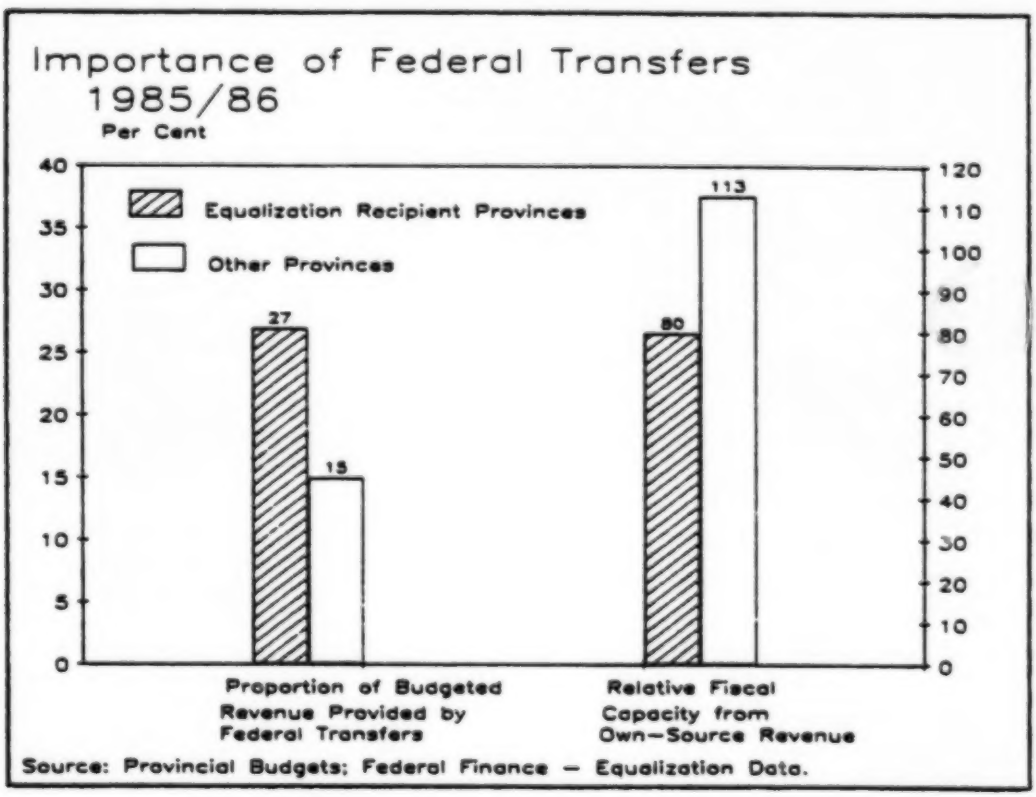
Chart 2



Federal projections now indicate that after the Bill C-96 cutbacks, cash transfers for health and higher education will show very limited growth of only in the range of 2% annually through 1990/91. Coupled with inadequate equalization, federal transfers, which in total provide from 22% to 46% of provincial Budgets in equalization-recipient provinces, will grow less than inflation. The costs of maintaining quality health care for an aging population, which needs and deserves more medical services, will grow faster than inflation. Education is a vital investment for young Canadians and others seeking retraining or new skills. Efforts to foster economic development in recipient provines must also be strengthened. Other services must be maintained. Debt-servicing costs are growing in each recipient province.

The balance of provincial revenue sources -- income taxes and other own-source revenues -- cannot compensate for the minimal growth in federal transfer payments in equalization-recipient provinces for two reasons. Federal transfers, as a proportion of total revenue, are nearly twice as high in the recipient provinces. And the capacities to raise revenue from their own sources are substantially lower in recipient provinces than in the richer provinces. For example, on a per person basis, one point of personal income tax yields $9.66 per capita in Newfoundland, $19.94 in Ontario, $14.01 in Manitoba and $20.68 in Alberta.

Chart 3



The effects of reduced federal transfers on programs and on provincial fiscal circumstances are well-known. The federal government's Task Force on Expenditure Review put it clearly:

> "Reductions in federal funding under EPF will, for the provinces, result in one or more of the following:
>
> - transfer of health costs to individuals (within the limits of the Canada Health Act);
>
> - increased taxes at provincial levels;
>
> - reduction in services and/or quality of health care services;
>
> - reduction in provincial programs in areas other than health care." [1]

These effects will be realized more quickly and more harshly in equalization-recipient provinces unless action is taken to make the equalization program adequate. It should compensate at least in part for the health and higher education cuts. With less ability to tax or to pass on costs to the sick (an unconscionable alternative which must be rejected in any case), reduction in programs and services are more likely. National standards may be compromised. Eventually, lower standards will affect those able to withstand the cutbacks for a longer period. Government costs may be reduced but at a price unacceptable to Canadians who value our public social services. And, regional disparities will be more pronounced.

That is why Manitoba has taken issue with the limited "defence" of the equalization program and of other federal transfers given recently by the federal Minister of Finance to the American Council for Capital Formation in Washington. Mr. Wilson stated:

> "Not only do we (Canadians) use the state to provide certain goods and services, we also use the federal government to redirect resources between regions, thereby ensuring <u>minimum</u> national standards."

The Constitutional commitment is to <u>comparability</u> in services and tax levels not to minimum standards. That commitment must be met. Manitoba believes that federal transfers should enable the maintenance of <u>adequate standards</u>. The Minister's Statement defends only minimum standards which are not "reasonably comparable" and which may fall as a result of restricted growth in major federal transfers.

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[1] Health and Sport Volume — Study Team Report to the Task Force on Program Review, Page 90.

Equalization Formulae

Historical Review

From 1957 through 1962, equalization included only personal and corporate income taxes and succession duties, but the standard base was that of the top two provinces. The rationale for using the top two provinces included recognition of the desirability of equalizing to the level of the highest province, combined with considerations of stability and affordability. Starting in 1962, revenue coverage began progressively to be broadened. The standard was lowered in some years, but its level was always the National Average or the top two provinces. Finally, in 1967/68, the Representative Tax System as we know it was adopted, with the all-province National Average Standard, ten-province tax rate and a wide range of separately-based revenue sources. It continued in effect for the next 15 years, with some restrictions in the percentage of resource revenue coverage. During that entire period, the National Average Standard remained the consistent basis of the formula. Only in 1982/83, unilaterally and without provincial agreement, did the federal government abandon the National Average Standard and replace it with the five-province so-called representative average standard.

The 1982 Formula-Five-Province Standard

In theory, the current formula has 100% revenue coverage. However, by excluding Alberta and the Maritimes from the base, the five-province standard is roughly equivalent to a formula with exclusion of about 21.7% of all revenues (or 100% of resource revenues plus 6.5% of all others) from equalization. Thus, despite claims of "full coverage" of all revenues including natural resource revenues, the new formula in practice effectively removed the greater part of the critical oil and gas sources from the standard base.

The current formula also uses the ten-province tax rates applied to the five provinces' tax base. The ten-province tax rates are not representative of the mix of rates required to maintain services in the five provinces with their lower tax bases which are included in the standard. The formula lacks internal consistency and integrity.

The combined result of excluding the major portion of resource revenues from equalization and of using a tax rate structure which is insufficient to maintain services in the representative provinces, is the unacceptably low, slow-growing levels of equalization support witnessed since the 1982 formula was introduced.

Inadequacies of the Current Equalization Program

In good times and in bad the current equalization program has delivered much less than promised, far less than expected and certainly less than is needed.

Looking at the record and at the most recent federal projection for the next fiscal year, the picture of inadequate growth is clear.

Table 1

Total Equalization Support
All Provinces
(1984/85 to 1987/88)

	Current Estimates ($ millions)	Projection ($ millions)	Cumulative Change from 1984/85 ($ millions)	(%)
1984/85	5,430			
1985/86	5,124		<306>	<5.6>
1986/87	5,351		<79>	<1.5>
1987/88		5,513	83	1.5

Source: Federal Finance, October, 1986.

The yield of the 1982 formula has consistently been over-estimated by the federal government. This is a continuing problem. The current projections for equalization in 1988/89 are $1 billion less annually than projected just two years ago in the November, 1984 federal Economic and Fiscal Statement.

Table 2

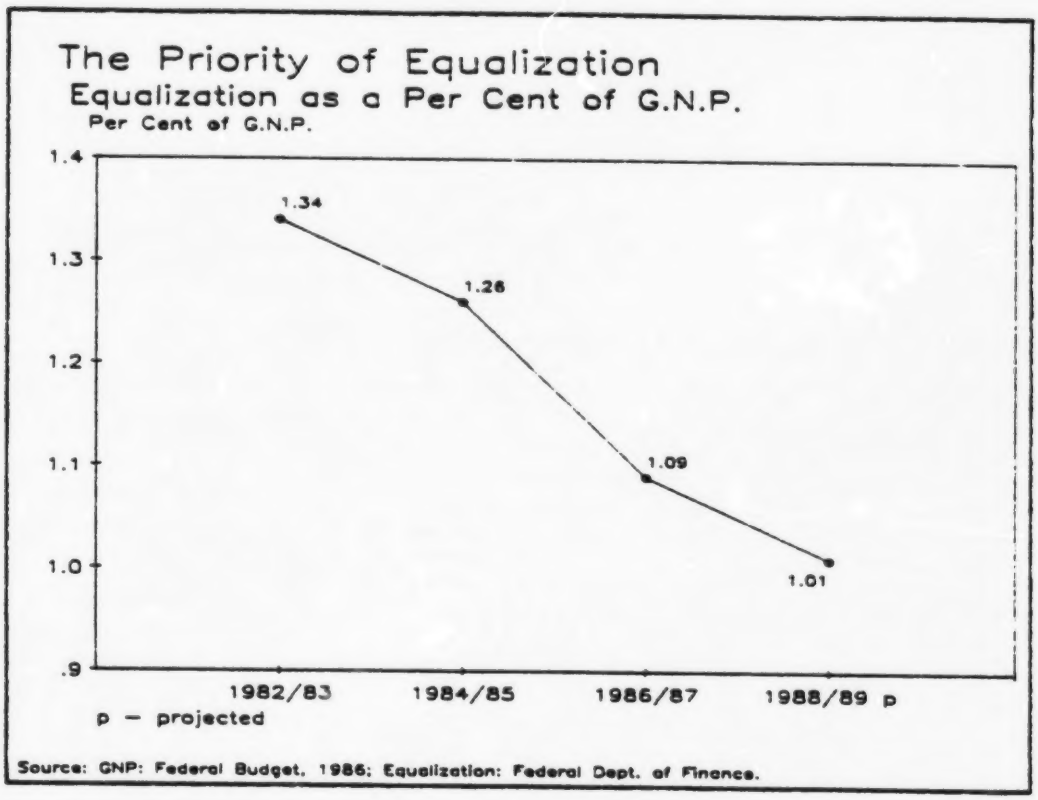
Federal Fiscal Framework
Equalization Projections
1984 and 1986
($ billions)

	1986/87	1987/88	1988/89
November, 1984	5.6	6.2	6.8
October, 1986	5.4	5.5	5.8
Difference	0.2	0.7	1.0

Source: Federal Department of Finance.

In 1982, when the five-province formula was imposed, equalization payments required 1.34% of GNP, a fair and manageable commitment. Since then, the share of the nation's resources devoted to equalization has fallen to 1.09% this year, and are projected to be down further, to near 1.0% within two years. If the five-province formula actually delivered the support suggested in the federal government's own fiscal plans, the problems with the program would be less acute. The priority of equalization would not be falling so rapidly, and a greater measure of regional equity could be maintained.

Chart 4



For Manitoba, the implications of continuing the current formula are particularly severe. Current federal projections suggest a year-overyear drop of $53 million in budgeted equalization support in 1987/88 while the same formula suggests Manitoba requires increased support to maintain services. And, some informal federal indications suggest the drop in 1987/88 could be even more severe.

Table 3

Total Equalization Support for Manitoba
1984/85 to 1987/88
($ millions)

1984/85	480
1985/86	466
1986/87[1]	511
1987/88[2]	458

[1] 1st Estimate — Federal Department of Finance.
[2] Estimate — October, 1986 — Federal Department of Finance.

Federal-Provincial Review of the Equalization Program

A year and one-half ago, Finance Ministers instructed their officials to begin an intensive review of the equalization program leading to a renewed program which must be in place by April, 1987.

In initiating that review, it was recognized that the equalization arrangements, unilaterally imposed by the former federal administration in 1982, had proven to be seriously inadequate and that major improvements were required. Not a year passed without the necessity of special transitional or ad hoc provisions. Independent analysis by Economist Tom Courchene and former federal Finance Deputy Mickey Cohen concluded that Manitoba, along with Quebec, had been hit hardest by the 1982 changes. Yet equity amongst the equalization-recipient provinces was not the major concern in the years since 1982. The inadequacy of the total formula was and remains the primary issue.

Certainly, the formula also needs regular examination to ensure that it incorporates the best measures of revenue raising capacity available. To that end, important work has been undertaken and a package of technical base changes has been developed. The technical review can and should continue. In this connection, Manitoba supports the package of technical changes together with the proposal that an adequate urban scale adjustment for the commercial and industrial portion of the property tax base be incorporated in the formula in 1987.

However, technical adjustments are just that — technical adjustments — and nothing more. They do not correct for the lack of adequacy, consistency and integrity in the current five-province standard formula imposed in 1982.

Federal argumentation that the technical changes represents an improvement of $175 million annually ring hollow in the face of the $1 billion annual drop in federal estimates of equalization for 1988/89 since the officials' review commenced.

Equalization-recipient provinces are also waiting for action on federal commitments to compensate the poorer provinces for the health and higher education funding cutbacks. Table 4 below shows the magnitude of improvement necessary to compensate for the C-96 cutbacks.

Table 4

Losses in Federal Funding for Health and Higher Education Due to Bill C-96
($ millions)

	Manitoba	Total Equalization-Recipient Provinces	Total All Provinces
1986/87	13	122	318
1987/88	29	267	681
1988/89	46	426	1,089
1989/90	65	602	1,547
1990/91	86	796	2,054
Total	239	2,213	5,689

Source: Federal Finance, February, 1986.

The governments of Manitoba, Quebec, Newfoundland and Saskatchewan have presented proposals for modification to the standard and the formula. A strong consensus has emerged that a return to equalization based on the all-province national average standard would better meet the Constitutional objective of the program.

To date, the federal Department of Finance has not responded positively to the proposals made to improve the formula.

The current five-province "representative average" formula provides equalization support some $1.8 billion below the total of full equalization under a national average standard. That is a large sum, especially to the six recipient provinces. It is compelling evidence of the failure of the five-province standard to provide sufficient resources to maintain comparable services in the "have-not" provinces with comparable tax rates. These provinces are facing difficult fiscal circumstances and deficits. They are trying to meet the essential and growing health, education and other needs of their citizens. Each has less than the national average revenue raising capacity to draw on.

Some have argued that any proposals to close the $1.8 billion gap between current and full national average equalization standards is unrealistic, given the current federal fiscal situation. Interestingly, if equalization support since 1982 were growing only at the same rate as national economic growth, equalization would be projected at $1.8 billion more by 1988/89. This simply means that by maintaining the priority equalization received in 1982, the gap could be closed by 1988/89.

Table 5

Maintaining the Priority of Equalization
($ billions)

	1982/83	1984/85	1986/87	1988/89
Equalization at 1.34% of GNP	4.9	5.8	6.7	7.6
Current Equalization Estimates				
$ millions	4.9	5.3	5.4	5.8
% of GNP	1.34	1.26	1.09	1.01
Shortfall from 1982 Level	-	0.5	1.3	1.8

Sources: GNP Forecast — Based upon 1986 Federal Budget;
Equalization — Current Estimates — Federal Department of Finance.

In this connection, it is worth examining the fiscal plans of the current federal administration. As documented earlier, as recently as November, 1984, equalization projections were nearly $1 billion higher for fiscal year 1988/89 than the current federal forecast. In November, 1984, Ottawa argued that its fiscal plan necessitated the cut of $2 billion from federal cash transfers for health and higher education but did not require further transfer cuts. Based on such analysis, the unanticipated $1 billion decline in equalization under the five-province formula should provide room within the federal fiscal plan for improving the adequacy of the equalization formula.

It should also be noted that within their fiscal plans, Ottawa has found more than $3 billion annually for capital gains tax exemptions and increased RRSP tax breaks for higher income Canadians and corporate income tax rate reductions.

It is obviously only a question of federal priorities:

- $2 billion cut from federal EPF transfers to provinces;
- $1 billion more gained through the inadequacies of the equalization formula;

- $5 billion cut from the federal expenditure envelope for regional and economic development;

- contrasted by $3 billion annually in new tax exemptions for wealthier Canadians.

Provincial proposals have been mindful of the federal fiscal situation. They have been put forward positively and constructively. An equally positive and constructive federal response is required.

The Manitoba Position

The priority of equalization to meet the Constitutional commitment must be restored.

Restoring the adequacy of the equalization program is of great concern to all Manitobans. Without modification to the present formula, Manitoba faces a $53 million drop in equalization support for next year, despite increasing need for equalization support. Clearly, such a major drop, despite increasing need, cannot be absorbed without:

- service cuts;
- increased taxes; and/or
- higher deficits.

In principle, therefore, equalization support to any recipient province must not be cut unless its need for support is decreasing.

The continuation of the inadequate equalization formula under the five-province so-called representative average standard would be unfair.

Manitoba, along with other provinces, has proposed a return to a standard of equalization based on the ten-province national average standard.

Manitoba has also advanced formula options based on a percentage of the national average standard. This would provide flexibility, lacking in past formulae, to raise the standard as federal fiscal circumstances permitted over the next five-year period of the equalization arrangements.

The bottom line for Manitoba is to receive a federal commitment to improve upon the inadequate equalization arrangement which is now in force.

Conclusion

The Constitutional commitment to regional development and the reduction of regional disparities must be honoured.

The provinces have been hard hit by the series of federal transfer payment cutbacks beginning in 1981. Unfair treatment has resulted in Manitobans suffering more greatly than others.

The social infrastructure of Canada is being threatened by these federal actions. The threat is greatest in the equalization-recipient provinces which have less fiscal capacity to absorb the shocks provided by federal government. Regional disparities and tensions are likely to grow unless corrective action is taken.

The equalization system is now under review. It is time to renew the federal commitment to fairness and to equity for all Canadians. The equalization program needs improvement now.

Canadians in all parts of the country will support federal action to fully meet its Constitutional commitments and to work with provinces to maintain and build upon our social and economic foundations.

APPENDIX

Honourable Eugene Kostyra
Minister of Finance
Province of Manitoba

NOTES FOR A STATEMENT ON FISCAL ARRANGEMENTS

Finance Ministers' Meeting
Edmonton, Alberta
October 31, 1986

Background

Over a year ago, Finance Ministers instructed their officials to begin an intensive review of the equalization program leading to a renewed program which must be in place by next April.

In initiating that review, we all recognized that the equalization arrangements, unilaterally imposed by the former federal administration in 1982, had proven to be seriously inadequate and that major improvements were required. Not a year passed without the necessity of special transitional or ad hoc provisions. Independent analysis by Tom Courchene and former federal Finance Deputy Mickey Cohen concluded that Manitoba, along with Quebec, had been hit hardest by the 1982 changes. Yet equity amongst the equalization-recipient provinces was not the major concern in the years since 1982. The inadequacy of the total formula was and remains the primary issue.

The timing of the five-year review was auspicious. The federal government was proceeding with Bill C-96 to limit its support to health and higher education. At an early stage, provincial Finance Ministers looked to the equalization review as a process which could be useful in ensuring that the negative effects of EPF transfer cuts would not place in greater jeopardy the health and higher education programs of the poorer provinces. These provinces had less fiscal capacity and flexibility to cope with the reduction in federal support, which for equalization provinces alone totals $122 million this year, $267 million in 1987/88, rising to $796 million in 1990/91. And, last spring, before the passage of Bill C-96, we were heartened to hear federal assurances that improvements to equalization would be seriously examined as a way to offset the EPF cutbacks.

The Importance of Equalization

It is difficult to overstate the importance of equalization to the Canadian federation. Often referred to as "the glue which holds the federation together," the commitment to equalization has been enshrined in our Constitution alongside the commitment to regional development.

All governments in Canada have supported the Equalization Program. Federal Finance Minister Michael Wilson emphasized the willingness of Canadians to support equalization in his recent comments to the American Council for Capital Formation in Washington. He stated:

> "Not only do we (Canadians) use the state to provide certain goods and services, we also use the federal government to redirect resources between regions, thereby ensuring minimum national standards in all parts of the country. In fact, Canadians feel so strongly about this concept of sharing that the principle of equalization is now entrenched in our Constitution. And, Canadians in wealthier parts of the country have been willing to pay the price for that principle...in the form of higher federal government spending levels and higher federal taxes than otherwise would be the case."

Of course, at our last meeting, we pointed out that the Constitution envisaged comparable standards rather than minimum as referred to in those remarks.

As I stated at our last meeting, Canada's equalization program is founded upon the principles of fairness and of sharing the benefits of the Canadian federation. It serves vitally important social purposes. Equalization may also be the most important regional development program in Canada. Without the ability to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation" -- the objective of the program as set out in the Constitution -- the poorer provinces remain at an unfair disadvantage in attracting or developing industry and commerce and in financing their own economic development initiatives. That is why the priority of equalization must be restored.

Inadequacies of Federal Transfers

Manitoba recognizes that the federal deficit is higher than any federal Finance Minister would want it to be. We believe fair tax reform is part of the answer to that situation. But federal deficits do not mask the fact that equalization recipient provinces have

seen their fiscal situations deteriorate markedly since 1981, in part, as argued by the Province of Quebec, because of the inadequacies of federal transfers including the equalization program. As our current federal Finance Minister said in 1982, such a transfer of deficit burden from the federal to the provincial governments is "predatory federalism."

Moreover, each new set of federal forecasts shows lower entitlements for provinces than previously estimated.

In November 1984, the Economic and Fiscal Statement projected federal cash payments for health and higher education of $12.2 billion by 1990/91. After Bill C-96, current projections are for payments of $9.8 billion in 1990/91 -- $2.4 billion less (not $2.0 billion) than federal projections only two years ago.

In 1984/85, regional development expenditures totalled $14.7 billion. But, only $9.1 billion is allocated for regional development in 1987/88 -- $5.6 billion cut from the Economic and Regional Development Envelope.

In November 1984, equalization payments were projected for 1988/89 at $6.8 billion. Currently, 1988/89 payments (the last year for which federal estimates have been shared with the provinces) are estimated at $5.8 billion -- $1 billion below the estimate of two years ago.

A further illustration of the failure of the current equalization progam is that equalization payments have actually fallen from 1.34% of GNP in 1982 to 1.09% in the current year and are projected to fall further, to below 1.01% in 1988/89.

The pattern of inadequate equalization support under the five-province so-called "representative average" standard continues. We must move to address that issue in the current equalization review.

To restore equalization to the same priority of the nation's resources as in 1982 would require a $1.3 billion increase in 1986/87 and $1.8 billion in 1988/89 over current projections.

The declines raise serious questions about the federal government's commitment to maintaining vital public services and fostering regional economic development across Canada. Unless redressed, they suggest that equalization and regional development will be sacrificed for deficit reduction and other priorities.

Some may argue that the federal fiscal framework precludes more adequate equalization support. However, such argumentation does not stand up to scrutiny. Billions of dollars have been found within the same fiscal framework for capital gains exemptions, RRSP deduction increases and corporate rate reductions. In our view, adequate and fair equalization is more important than such give-aways.

Improving the Equalization Formula

As mentioned earlier, adequacy is the primary issue for the equalization review. Nonetheless, the formula also needs regular examination to ensure that it incorporates the best measures of need available. To that end, important work has been accomplished and a package of technical base changes has now been proposed for implementation in 1987. That technical review can continue and Manitoba supports the argumentation for inclusion of adequate urban scale adjustment for the commercial and industrial portion of the property tax base.

The equalization formula based on a five-province standard along with ten-province tax rates lacks cohesiveness and integrity. It produces support levels to recipient provinces insufficient to achieve the objectives of the program. It does not deliver adequate equalization growth.

And let us not fool ourselves, the problems with that formula have not ended. Indeed Manitoba, under current federal projections, will suffer a major $53 million cut in equalization payments next year while our need as measured under the formula continues to increase. Indeed, unless some improvement is afforded, Manitoba's equalization payments will have actually fallen on a per capita basis over a five-year period despite the fact that its measured need has shown increases in each of those years.

This is not solely a Manitoba issue. Five recipient provinces fell into the transitional arrangements; all six recipient provinces received supplementary payments. Simply put, the formula does not work -- it is inadequate and it lacks flexibility to respond in needed measure to fiscal circumstances.

Manitoba has long argued that a return to the ten-province national average standard is desirable and fundamental to a fair system. We reaffirm that position.

In our view, a return to the national average standard is also compatible with federal affordability concerns. If the nation were devoting the same share of GNP to equalization in 1986/87 as in 1982/83, ninety percent of the gap between the five-province standard and the national average standard would be closed.

Manitoba, Newfoundland, Saskatchewan and others have put forward proposals related to the national average standard. However, it is recognized that the federal government, given its fiscal circumstances and the lower priority they have attached to equalization and regional development, may be reluctant to immediately provide the funds necessary for full equalization under a national average standard. Therefore, Manitoba has put forward a proposal, quite similar to Newfoundland's proposal, that the equalization formula be a proportion of the national average standard which increases towards the full national standard gradually as fiscal circumstances permit.

I am disappointed that Manitoba's proposal and proposals from other provinces for improving the adequacy of the formula have not yet received serious consideration from the federal government. But, there is still time. What is urgently needed is the will and direction. We are hopeful that will be forthcoming today.

Honourable Eugene Kostyra
Minister of Finance
Province of Manitoba

NOTES FOR A STATEMENT
ON EQUALIZATION

Finance Ministers' Meeting
Montreal, Quebec
September 19, 1986

Importance of Equalization

Canada's Equalization Program is founded upon the principles of fairness, of sharing the benefits of the Canadian federation, of maintaining the ability of governments across Canada to provide equitable conditions for their citizens.

In a time of fiscal stress and of economic uncertainty, it can provide a large measure of needed stabilization in the country's affairs. It can provide assistance when and where it is most needed.

All governments in Canada have supported the Equalization Program, and I was pleased to note the recent comments of federal Finance Minister Michael Wilson to the American Council for Capital Formation in Washington:

> "Not only do we (Canadians) use the state to provide certain goods and services, we also use the federal government to redirect resources between regions, thereby ensuring minimum national standards in all parts of the country. In fact, Canadians feel so strongly about this concept of sharing that the principle of equalization is now entrenched in our Constitution. And, Canadians in wealthier parts of the country have been willing to pay the price for that principle...in the form of higher federal government spending levels and higher federal taxes than otherwise would be the case."

Background -- Recent History

The equalization formula imposed by the federal government in 1982 has been inadequate in several respects. I wish to speak mainly about only two.

Based on the five-province so-called representative average standard, the current formula has generated inadequate payments. For most of the period, the fiscal capacity after equalization of recipient provinces has been roughly 15% below the all-province national average, in part because some major resource revenues are only marginally reflected in the formula.

That shortfall has recently changed to about 10%, not because of an increase in equalization payments, but rather because of the drastic resource revenue drop in Alberta and Saskatchewan. In fact, total equalization payments in 1986/87 of $5.30 billion are projected to remain below the 1984/85 level of $5.44 billion. If the increased cost of services in recipient provinces is taken into account, there is a very sizeable decline. In fact, the real value of equalization payments -- their ability to maintain service levels -- is falling, whether it is measured against Gross National Product, against inflation, or against the needs of an expanding population. Yet, there is no good reason for such a decline since, by objective measures, the fiscal positions of recipient provinces have not improved.

The inadequacies of the basic formula is reflected in the heavy reliance on ad hoc measures -- transitional arrangements, supplementary payments, floor payments and equalization-offset arrangements.

Heavy reliance on ad hoc measures has threatened longer-term stability of provincial revenue growth. It would be far preferable to have an adequate formula which increases support whenever a province's needs increase.

Other Considerations

In this connection, efforts must be made to improve our joint forecasting and measurement capability. I am not convinced that co-operation on projecting the effects of current commodity prices and other economic factors on current and future years' equalization payments has been adequate. Provinces have been denied access to five-year forecasts of equalization arising from last February's Budget. No comprehensive analysis has been offered of the sensitivity of our equalization payments to a range of energy price scenarios. Sharp adjustments in payments related to one or more years, coming without adequate warning, makes fiscal management needlessly difficult.

Earlier, I referred to the federal Finance Minister's Statement of September 5, 1986. I would hope that a concern I have with that statement is only a matter of semantics. The statement refers to "ensuring minimum national standards" while the Constitutional provision is for "reasonably comparable services at

reasonably comparable levels of taxation". National standards are important in the measurement of reasonable comparability; but comparable does not and should not imply minimal.

At their August meeting, Premiers expressed their position that the cuts in federal support for health and higher education should be considered as a temporary measure only. That is necessary to prevent long-term damage to vital services. However, with the first cuts now being felt, a federal commitment to strengthen equalization is more crucial to safeguard against any deterioration in health and higher education services to Canadians in the poorer provinces.

As economic and social development go hand-in-hand, the importance of equalization to regional development must not be overlooked. It is no accident that the Constitutional commitment to equalization is alongside the commitment to regional development in Part III of the Constitution. Without the ability to provide reasonably comparable levels of public services at reasonably comparable levels of taxation, the poorer provinces remain at a distinct disadvantage in attracting or expanding the productive base necessary for balanced regional development.

Proposals

Along with other provinces, Manitoba affirms the importance of devising and putting into place a comprehensive equalization formula with the capacity to achieve its Constitutional commitment to equalization. To this end, we have a number of proposals:

1) The formula must be adequate. It should be judged on its ability to better meet its constitutional objective. Other federal transfers, after recent cuts, now provide a smaller share of provincial revenue; so equalization is becoming more crucial to the provision of comparable services with comparable taxes in the have-not provinces. Consideration must therefore be given on a priority basis to formula alternatives which will prevent deterioration in the relative position of recipient provinces, and which, over time, will increase the fiscal capacity

of equalization-recipient provinces relative to the national average standard. Without such progress in equalization, there will be increasing inequality of levels of public service available to Canadians in different regions and provinces. Regional development will suffer.

2) The federally-proposed package of tax base adjustments should be tentatively accepted and attention turned to other aspects of the formula. In a general sense, technical tax base adjustments can improve the measurement of relative provincial tax capacity, but we cannot fully evaluate them without reference to our equalization standard. Certain adjustments, particularly those concerning resource tax bases and revenues, would work best only with certain formula options.

3) A principle must be incorporated in the formula that prevents payments to a recipient province from declining if its measured need is increasing.

4) This program cannot be on the table for negotiation within freer trade talks.

5) It should go without saying that the governments must have the necessary historical data and consistent forecasts for the next five years in order to consider the improvement of the Equalization Program. The equalization review cannot be completed in the absence of such information.

In view of the desire by all governments to achieve consensus on equalization as soon as possible, I would suggest our officials be directed to work expeditiously on assuring the basic information on equalization is available and on options to improve the formula. While our time line must be kept flexible and our work plan somewhat open-ended to allow all the necessary preparation before the new formula is selected, we should expect to receive a comprehensive report prior to our next meeting.

Honourable Howard Pawley
Premier of Manitoba

NOTES FOR A STATEMENT

ON FEDERAL-PROVINCIAL FISCAL RELATIONS

Provincial Premiers' Conference
Edmonton, Alberta
August 10 to 12, 1986

Introduction

I am pleased to have this opportunity to lead off our discussion of federal-provincial fiscal relations. As all of us at this Conference know, fair and equitable fiscal arrangements, involving both the sharing of the revenue base and federal transfers are necessary to ensure that provinces have the capability of meeting their responsibilities and of adequately serving the needs of Canadians across the nation.

In the forefront of federal-provincial fiscal issues this year are:

- the provision of adequate funding for health and higher education;
- equalization and regional development; and
- tax reform.

These are important questions with implications for all Canadians. How federal and provincial governments deal with these issues now will have significant effects on social and economic development throughout Canada for the balance of this century.

Health and Higher Education

Last year in St. John's, Newfoundland, Premiers unanimously rejected federal proposals to cut federal support for health and higher education programs. Our communique noted and I quote:

> "federal cutbacks are clearly inconsistent with maintaining present levels of service, let alone meeting projected needs."

Similar conclusions were reached by the Nielsen Task Force.

And there is the continuing reality that poorer provinces have a more difficult time finding resources to compensate for federal cutbacks while maintaining competitive tax levels and other economic and social development initiatives.

Regrettably, the federal government turned a deaf ear to the provinces and to concerns of men and women throughout the country and proceeded unilaterally with cutbacks in support for health and higher education.

However, the long-term consequences of inadequate federal funding are still ahead of us. There is still time to act to protect and enhance health and higher education services to meet the needs of all Canadians.

Last year, U.S. health care spending increased to 10.7% of GNP from 10.4% in 1984, to meet the increasing demands and needs of citizens, and especially the rapidly increasing numbers of senior citizens, for health care services.

While Canadian health care is more efficient and effective, we are facing a similar increase in needs and similar underlying cost trends to those evident in the United States and elsewhere.

Federal Health Minister Jake Epp has indicated that he will present a health strategy paper in November, some eight months after the federal cutbacks started to take effect. We deplore this "cut-first, plan-later" approach. Nevertheless, Manitoba continues to believe that a national planning process to identify needs, appropriate program stategies and fiscal requirements is crucial. We are prepared and anxious to meet with the federal and other provincial governments for this important purpose.

Health Ministers and the Council of Ministers of Education will hold meetings in September. We could direct these Ministers to provide further information on the requirements of Canadians for health and higher education services and on means of assuring the needed resources. A preliminary report could be requested prior to the First Ministers' Conference in November.

For all these reasons, it is important that First Ministers revisit the health and higher education funding issue in November, including the Alberta suggestion that the provisions of Bill C-96 must be treated as a temporary measure. This could avert long-term damage to fundamental services.

Equalization and Regional Development

Earlier, we discussed regional development broadly, in the context of the economy. Success in our commonly held goal of ensuring equitable development throughout Canada requires that the regional dimension of all federal activity be examined carefully and where possible improved and strengthened.

The importance to the regions of Canada of federal initiatives in many program sectors including agriculture and transportation is very great, as are co-operative efforts through regional development agreements and direct federal purchasing and activity.

It is no accident that the constitutional commitment to equalization is alongside the commitment to regional development in Part III of the Constitution. The commitment to Equalization is to ensure that provinces can provide "reasonably comparable levels of public services at reasonably comparable levels of taxation." Clearly that is crucial to regional development just as policies to foster balanced

regional development are crucial to the capacity of provinces to provide adequate services with competitive taxes.

As is well known, the equalization formula imposed in 1982 substantially reduced basic equalization entitlements of provinces. The current formula leaves recipient provinces some $850 annually for a family of four short of the all-province average capacity to raise revenue. The wide divergences in tax levels and rates resulting from these shortfalls are a concern.

Fundamental changes are necessary, including, in our view, raising the standard of equalization from the current five-province, so-called "representative average," imposed in 1982 to the all-province national average. Such a change becomes even more crucial if the health funding cutbacks are not rescinded. We could direct our Finance Ministers to develop formula changes and other options to reflect a strengthened commitment to equalization.

Tax Reform

Manitoba has long advocated comprehensive tax reform to:

- improve fairness and equity;
- protect the ability of federal and provincial governments to raise adequate revenues to maintain vital services;
- further goals of effectiveness, efficiency and simplification.

The recently stated federal intention to reverse the long-term shift of taxation from the corporate sector to the personal sector is consistent with the position Manitoba has taken over the years. And, the recent federal commitment to comprehensive reform is welcome.

The case for reform is strong, and never stronger than now when governments' collective capacity must be protected. Returning to a tax system akin to that of 1961 would not be reform.

At times, the federal government has linked its discussions of tax reform to providing tax rates "competitive" with those in the United States. We should be careful in making such comparisons, to take into account differences in social services. For example, Canadian taxes pay for Medicare, while Americans must be provided with medical coverage through the workplace or from their pay cheques. Tax levels set "competitive" with U.S. taxes would not provide adequate funds to continue Medicare.

We need a "made in Canada" policy which recognizes the advantages the country has because of our social heritage.

Provinces have a vital interest in tax reform and must be involved in formulation of options and objectives. Finance Ministers should be directed to report back to us on tax reform before the First Ministers' Conference.

Summary

To summarize, Canadians need and deserve fair and secure financing for essential health and higher education programs. As a nation, our commitment to equalization and regional development should be strengthened. Tax reform is urgently required to support our economic and social goals.

These issues are interlinked. The provinces have a vital concern in each area. First Ministers, Ministers of Finance and Ministers responsible for key program areas must be involved. Much work can be done on these issues prior to the First Ministers' Conference in November.

The pillars of federal-provincial fiscal arrangements must be strengthened if the Canadian federation is to stand firm and continue to provide a good and secure home for all of our citizens.

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27TH ANNUAL PREMIERS' CONFERENCE

Communique on Federal-Provincial Relations/Tax Reform

August 10-12, 1986
EDMONTON, Alberta

27TH ANNUAL PREMIERS' CONFERENCE
Edmonton, Alberta
August 10-12, 1986

COMMUNIQUE ON FEDERAL-PROVINCIAL RELATIONS/TAX REFORM

The Premiers reviewed the state of federal-provincial relations and noted the need for joint planning for the 2nd Annual First Ministers Conference to be held in November, 1986. The Premiers welcomed the Annual First Ministers Conference as an opportunity to discuss, cooperatively, matters of mutual concern.

FEDERAL-PROVINCIAL AGREEMENTS

Premiers recognized that Federal-Provincial agreements and arrangements have become an important instrument of government. They expressed concern that unilateral changes to these agreements and arrangements are very disruptive. In particular, they noted the recent changes to the Fiscal Arrangements Act. Premiers suggested that the development of mechanism to give greater certainty to such arrangements be explored.

They view the current reduction in the growth of federal transfers for social programs as a temporary measure and reiterated the importance of adequate federal funding for these programs.

The Premiers called on the federal government to ensure that the equalization program meets the Constitutional commitment to enable provinces to provide "reasonably comparable levels of public services at reasonably comparable tax rates".

They concluded that agreements on fiscal arrangements should be a major topic on the agenda of the First Ministers Conference in Vancouver.

TAX REFORM

The ten provincial Premiers welcomed recent federal statements committing the federal government to comprehensive tax reform. Premiers agreed that the implications for major provincial taxes must be considered. They noted that the federal commitment was consistent with earlier statements by the Premiers which stressed the need for tax reform to improve fairness and simplicity in taxation.

The Premiers identified economic development and competitiveness as vital objectives which must also be served, while recognizing the revenue requirements to finance national social programs. The impact on employment as well as on regional and sectoral economic strengths will be important criteria for assessing tax reform options.

The Premiers noted that important social objectives are met through both direct social programs and taxation policies. They agreed that tax reform should be truly comprehensive and improve harmony between taxation and expenditure programs.

The Premiers stressed that tax reform must not be used by the federal government as an excuse to erode provincial health and post-secondary education support by further cutbacks in transfer payments.

The process of tax reform must be open to consultation among all Canadians. But they agreed that it can only be successful with the co-operation of the provinces, since provincial taxes form an important part of the country's revenue system. The Premiers emphasized the need for federal-provincial consultation, co-operation and consensus building. They recommended that tax reform be on the agenda of this November First Ministers Conference. They directed their finance ministers to meet in preparation for that discussion.